

# Confusion about Custom: Disentangling Informal Customs from Standard Contractual Provisions

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## I. CUSTOM VERSUS EXPLICIT CONTRACT

What is the place of custom in the creation and enforcement of commercial obligations? Lisa Bernstein addresses that question with a frontal assault on the working rules that the Uniform Commercial Code (“UCC”) prescribes for interpreting commercial promises. Her opening salvo notes that the UCC is “based on the premise that unwritten customs and usages of trade exist and that in commercial disputes they can, and should, be discovered and applied by courts.”<sup>1</sup> The relevant landscape is shaped by UCC § 1-201(3), which defines an agreement to include “the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance.”<sup>2</sup> It is also found in comment 1 to UCC § 1-205, which instructs courts to find “the meaning of the agreement of the parties . . . by the language used by them and by their action, read and interpreted in light of the commercial practices and other surrounding circumstances.”<sup>3</sup>

To most individuals, these provisions seem to support the underlying principle of freedom of contract. It therefore comes, perhaps, as something of a shock to learn that Bernstein has demonstrated in meticulous detail that the empirical predicate on which this premise rests is, not to put too fine a word on it, often false in fact. Bernstein studies the evolution of trade rules in a number of specific industries; in each case she finds a constant pressure to depart from the gradual modification of trade usage by informal processes, such as those idealized by F.A. Hayek in

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<sup>1</sup> Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U Chi L Rev 710, 711 (1999).

<sup>2</sup> UCC § 1-201 (ALI 14th ed 1995). Other uses of trade usage and course of performance include UCC §§ 2-202 (“Final Written Expression: Parol or Extrinsic Evidence”) and 2-208 (“Course of Performance or Practical Construction”).

<sup>3</sup> Id § 1-205 cmt 1.

his treatment of spontaneous evolution.<sup>4</sup> Instead the changes in standard trade practices are brought about by the conscious, deliberative acts of trade associations. This reform process leads to the adoption of explicit contractual provisions that displace custom in two senses. First, the new standard trade provisions (which themselves offer a menu of options) become the sole source of authority, one that should not be displaced by an appeal to evidence of either trade practice or course of performance, as the UCC envisions. Second, the new explicit provisions often deviate in conscious and purposive fashion from the discordant set of customary practices that previously held these industries in their grip. The purpose of trade association deliberations is not simply to record and ratify observed past practices. It is to select the best past practices, to craft and to mold them, all in order to respond better to the concerns and the needs of the trade.

It is fair to ask what light Bernstein's findings shed on the role of private contract in commercial settings and on the use of custom as a source of law. At first blush, it might appear that her findings thrust a dagger in the sides of those, like myself, who have championed the use of custom in understanding and defining legal obligations.<sup>5</sup> Yet a closer look at this situation reveals the exact opposite conclusion; Bernstein's results do not denigrate the role of custom, properly understood, in commercial transactions. Rather, they reinforce the importance of freedom of contract in commercial life and show how the UCC managed to deviate broadly from that principle, notwithstanding its own basic commitment to freedom of contract found in Section 2-303, whose vital words "unless otherwise agreed" are the hallmark of all substantive provisions found in the Code.<sup>6</sup>

To see how custom should be integrated with contract law, it is important to isolate an important ambiguity that creeps into the innocent phrase "customary commercial term." One interpretation of this phrase stresses that most complex commercial ar-

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<sup>4</sup> F.A. Hayek, 1 *Law, Legislation and Liberty: Rules and Order* 35-54 (Chicago 1973). For Bernstein's criticism, see Bernstein, 66 *U Chi L Rev* at 754-59 (cited in note 1). Hayek's position does not square with the universal creation of constitutional norms either. See, for discussion, Richard A. Epstein, *Hayekian Socialism*, 58 *Md L Rev* 271, 282-84 (1999).

<sup>5</sup> Richard A. Epstein, *The Path To The T.J. Hooper: The Theory and History of Custom in the Law of Tort*, 21 *J Legal Stud* 1 (1992).

<sup>6</sup> "Where this Article allocates a risk or a burden as between the parties 'unless otherwise agreed', the agreement may not only shift the allocation but may also divide the risk or burden." UCC § 2-303 ("Allocation or Division of Risks"). This provision converts most of the substantive provisions of the UCC into default provisions, subject to some exceptions for unconscionability, such as UCC § 2-302, which in any event does not apply to transactions between merchants.

rangements are incomplete. Customary commercial terms are thus thought to offer the ideal set of gap fillers when commercial agreements are silent: hence the role of “unless otherwise agreed” in the UCC. Yet in many cases, a “customary commercial term” carries with it another distinct meaning: it refers to those express provisions that the parties commonly incorporate into commercial arrangements. Sometimes these explicit terms are taken from trade handbooks. Sometimes they have just evolved within the trade, without any conscious elaboration. For these purposes, it hardly matters. It is their standard usage, not their provenance that counts. The key point is that we must distinguish between “implicit customs” and “standard provisions” to understand the operation of this branch of contract law.

UCC Sections 1-201(3) and 1-205 comment 1 confuse these two conceptions of custom insofar as they appear to allow the use of implicit customs to override the explicit contractual terms.<sup>7</sup> Bernstein, for example, associates custom primarily with its default sense when she notes that the emergence of Hayekian-like implicit customs need not lead to efficient default norms.<sup>8</sup> But these criticisms do not apply with equal force to customary (that is, standard) provisions generated by trade associations for their members’ use. No one can assume, of course, that any set of rules will be perfect. But here the dangers that one faces are not those that stem from the awkward evolution of trade custom. Such customs may be hard to credit because of their unwelcome sensitivity to the choice of their initial starting points. Let a custom begin between A and B, and it may then follow a path different from that it would have taken if it had begun between C and D. The fortuity of initial starting points thus undercuts any claim, or so we are told, that distinct customary practices will all converge to an efficient solution to commercial problems. Worse, as Bernstein clearly points out, in practice implicit customs often do not converge to any determinate standard at all. Instead we find a wide canvas on which the same problem is tackled in different fashions by different groups at about the same time. Each custom expands within some limited community, and within that community that

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<sup>7</sup> See text accompanying notes 19-21.

<sup>8</sup> Bernstein, 66 U Chi L Rev at 753-54 & nn 174-75 (cited in note 1) (referring to earlier accounts that stress the inefficiency of custom). For a kinder view toward commercial norms, see Eric A. Posner, *Law, Economics and Inefficient Norms*, 144 U Pa L Rev 1697 (1996) (arguing that the relative efficiency of norms versus state-created rules depends on the context), and Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 J Legal Stud 377 (1997) (arguing that commercial practices, while not optimally efficient, are a good starting point for developing commercial laws).

expansion helps insure a concordance of implicit understandings. So localized, the dangers of decentralized customs are minimized. The variation among customs only creates genuine friction when the transactions take place between members of two different communities.

It seems quite likely that any localized custom suffers from this inefficiency. So what? Quite simply, this shortfall is not relevant to the question at hand. The source of commercial discord is not the abstract definition of an industry custom. Rather, it is the rise of unresolved disputes between two parties in different communities. The variation in implicit custom will only have a limited effect on this last question. The private parties whose transactions are governed by this melange of customs understand far better than professors and judges the weaknesses in their industry-wide customary practices. They also know that these perceived defects will not be fatal to all commerce, even if they impede the smoothness of trade. The hard question for traders within these different groups is whether the costs of fashioning a unified and coherent set of legal rules is too great relative to its promised benefits.

Answering that question depends on a close assessment of the relevant costs and benefits. In this regard it is instructive to note the leisurely pace at which deliberations often took place within trade associations. The National Hay Association ("NHA") took several years before it began the process of codifying its trade rules, and several more to complete the process.<sup>9</sup> The NHA took at least eleven years to decide on the definition of a contract carload.<sup>10</sup> The National Grain and Feed Association deliberated over twenty years before it promulgated a set of Feed Trade Rules.<sup>11</sup> The textile trade waited around eighteen years until it adopted its Worth Street Rules in 1936.<sup>12</sup> What is clear from this progression is that the issue commanded the extensive resources of these organizations; it would be rash to assume that the problems they faced were trivial. At the same time, it was equally clear that huge amounts of commerce doggedly went forward under a set of rules that set key participants at loggerheads with each other over the definitions of the fundamental terms of their trade. How can we explain the dicey situation where traditional commerce and legal reform proceed side by side?

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<sup>9</sup> Bernstein, 66 U Chi L Rev at 719-20 (cited in note 1).

<sup>10</sup> Id at 723 n 44 (explaining the period from before 1910 to 1921).

<sup>11</sup> Id at 725-29.

<sup>12</sup> Id at 732.

Any explanation for this apparent disjunction has to take into account the alternative control devices available to the parties. The starting point is that trade does not take place between strangers, let alone enemies. The frustrations of any inability to settle on standard definitions for key operative terms could be met in part by narrowing the circle of individuals with whom any given trader chooses to transact. So long as parties in repeat transactions share their own private understandings, they can continue to operate in peace even if out of step with the rest of the world. More broadly, they can trade with all merchants in a single area so long as any standard term or default practice is uniformly defined within that community. Again, it does not matter that outsiders do not understand how insiders view these key terms. It is a sufficient condition for successful commerce that each subdomain operate under internally consistent rules.

But what of the difficulties that remain? The starting point is simple: so long as trade takes place between individuals who are well-disposed to each other, the rough spots and misunderstandings can be smoothed over by informal means short of litigation. No matter what the legal rule, repeat players can agree to split the difference in close cases and count on good faith in long-term expectations to bridge the gaps.

These twin devices, however, impose two sets of costs. First, they impose some limit on the domain over which trade can easily take place. Second, the uncertainty in the rules generates costly, low-level disputes even when the parties to any given transaction act in good faith. What else could be expected when given contractual provisions carry different shades of meaning to each party? Both of these difficulties are likely to increase with the geographical expansion of the market. A broader terrain introduces potentially wider variation in contract terms; yet it reduces the level of repeat dealing, which in turn increases the risk that informal accommodations will not satisfy both participants to the dispute. It is evident that broader markets and better communications increase the gains from trade. It is equally apparent that variation in implicit customs and standard terms places a crimp on this process. The new entrant who increases competition in the market also increases uncertainty in standard contractual arrangements.

In practice, we are likely to see certain individuals step forward as "term arbitrageurs," that is, as persons whose knowledge of the dominant set of practices in each of two regional markets allows them to broker the differences between them. In the simplest sense, a bridge-merchant could recalculate the quality of a

bale of hay from the grading system of one region into the grading system of the second to ease the transition, just as some experts could learn to shift cargo from broad- to narrow-gauge track and back again. But this translation is costly at best and subject to breakdowns of its own. As the geographical expanse of the market increases, as goods are sold and resold, the pressure for standardized terms increases. Yet, by the same token, these middlemen also may choose to resist changes if they cut down on the use of their specialized talents. But even here we have to be cautious, for it could well be that these middlemen serve other functions that could benefit from the increase in the volume of business that standardization supplies.

Yet, notwithstanding the rising need for standardization, no amount of informal adaptations will bring the separate trading cultures into harmony, if only because the trade in any given region is a mixture of local trade (for which these new accommodations are unimportant) and external trade (for which these accommodations become ever more critical). Some merchants do one, some do the other, and still others do both but in varying proportions. Thus, any national association will be faced with a tricky governance problem in setting terms: all of its members favor convergence, but within that whole each group wishes convergence on terms that it finds most congenial. The dilemma is in effect a version of the standard battle of the sexes game, where both parties prefer to cooperate, but each wishes to do so on terms that give it greater benefit.<sup>13</sup> After much tribulation, these differences will iron themselves out, and a standard set of terms will emerge; even better, a standard menu of choices may emerge that allows one form to accommodate a wide variety of different transactions whose attributes are well understood, alone and in combination.

It is important, however, to note that this process of nationalization of trade practices could involve two distinct types of transformation. In some instances, it is a movement from implied

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<sup>13</sup> The simplest form of the game involves only a 2-by-2 matrix:

A\B	Custom A	Custom B
Custom A	2, 1	-1, -1
Custom B	-1, -1	1, 2

Both A and B wish to remain on the diagonal from northwest to southeast, but A prefers the solution (2,1) and B the solution (1,2). It takes a lot more than is presented here to figure out which solution pertains. For an early treatment, see Duncan Luce and Howard Raiffa, *Games and Decisions: Introduction and Critical Survey* 90-94 (Wiley 1957). Here are two complications. What result if one side announces his intentions early? What result if the failure to obtain agreement hurts one group more than it does another—that is, if there are asymmetrical negative payoffs in the southwest and northeast boxes?

custom to explicit terms. In others, it is the displacement of explicit local standard provisions by one explicit national standard. The first of these changes eliminates any uncertainty about the existence of some trade practice. The second harmonizes the express contract language across different regions. Both reduce the cost of contracting for all concerned. When someone states that he is in favor of custom in commercial contexts, I treat that as meaning only that he favors a world in which explicit contracts govern as written even if they clash with prior practice and earlier contractual provisions. The position is formalist insofar as it strives to make matters of interpretation self-contained and to exclude rigorously from view information that some disinterested Solon might regard relevant to the merits of the dispute. The whole point of these trade association reforms is to make commercial contracts look and operate more like negotiable instruments whose key terms are determined solely from within the four corners of the instrument, wholly without reference to extrinsic evidence.<sup>14</sup> The velocity of transactions across multiple parties, many of whom are strangers to each other, depends on the use of a single, simple code that all can know and none can alter unilaterally.

The question is how the UCC should work in this general legal environment. Typically, commercial success depends on the ability of the parties to draft complete-contingent-state contracts whose gaps (left to implied custom) arise only in rare cases. On this point, Bernstein is dead on.<sup>15</sup> Any gaps in implicit custom are filled to overflowing by standard agreements, chock-full with standard provisions, courtesy of local trade associations. The topics that matter are the topics that are covered. The ambiguities that matter are the ones that are first exposed and then eliminated.

In making this point, Bernstein helps undo one of the mischievous legacies of much mid-twentieth century scholarship, which acts as though complete-contingent-state contracts represent a remote and unattainable ideal. Friedrich Kessler and Grant Gilmore state the received wisdom that Bernstein's research should help displace:

A contract which contemplates future performance reflects not only assumptions as to the state of the real world now but predictions as to what that state will be next week or next month or next year. Only an infinitesimal fraction of

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<sup>14</sup> See UCC §§ 3-104, 3-115 for negotiable instruments.

<sup>15</sup> See Bernstein, 66 *U Chi L Rev* at 747-49 (cited in note 1).

these assumptions ever comes to the conscious attention of the parties; as with the iceberg, the great bulk of the contractual construct lies beneath the surface.<sup>16</sup>

Sorry. If anything, the ratio is reversed in standard merchant transactions. Only an infinitesimal fraction of contingencies (by probability of occurrence) are not covered; most of this iceberg floats above the surface. No one who has ever looked at a well-drafted trust instrument (a contract, as it were, for one person) could bemoan the paltry capacities of language; when time pressures and tactical issues are suppressed, the precision and completeness of language prove remarkable. The agreements that result from the deliberative processes of trade associations meet that same high standard.<sup>17</sup> Privy to their promulgation are merchants whose collective experience is in the hundreds of years. They have encountered or heard about all sorts of variations on the main theme. The common grist of the impossibility doctrine (which set the context for the Kessler and Gilmore quotation) are goods that are lost or destroyed in transit, delivered to the wrong party, captured by government agents, deficient in quality along any number of well-established dimensions. It is one thing to postulate a screw-up of monumental proportions in a distinctive transaction thrown together at the last minute without benefit of precedent: that happens all the time. But it is wholly incorrect to claim that knowledgeable parties who are closeted together for years can anticipate and correct only an "infinitesimal fraction" of their relevant business problems. The problem with botched transactions has to do with haste, and not with the power of language. The provision of standard term agreements reduces these pressures by allowing parties to make important trades on a moment's notice precisely because standard packages are available to facilitate them. So long as a row of future transactions is anticipated, the parties can bring their contracting difficulties under control. Once the stakes get high, the level of misunderstanding shrinks, even if occasional major mishaps still happen. The formalist project does not run aground on the shoals of mutual linguistic incomprehension.

The real challenge to these standard contract provisions rests, then, not on their indeterminacy, but on their substantive fairness. Yet, in this setting, the standard terms transaction of-

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<sup>16</sup> Friedrich Kessler and Grant Gilmore, *Contracts: Cases and Materials* 742 (Little, Brown 2d ed 1970).

<sup>17</sup> For a similar discussion, see A.W. Brian Simpson, *Contracts for Cotton to Arrive: The Case of the Two Ships Peerless*, 11 *Cardozo L Rev* 287, 304 (1989).



fers strong defenses for those who would uphold the validity of the disputed contractual provisions. Standard provisions are only accepted with broad support within the trade once they have survived deliberation and reflection. Using standard terms helps negate any charge that certain traders have been subject to sharp practice or discrimination. ("You got the same deal as Jones, so why complain?") The clarity of the terms reduces the strain on interpretive practices and minimizes the risk of inconsistent interpretations of standard provisions. Clear, standard terms also reduce the likelihood that unfair provisions will be sprung on unsuspecting amateurs who have no knowledge of local institutions and practices. The doctrine of unconscionability never had much of a run in transactions between merchants. It had even less traction when transactions with new traders followed established paths blazed by experienced parties. Nor do these contexts raise the familiar downside of standard contract provisions. These standard terms are directed toward the execution of individual contracts of purchase and sale. The standard forms usually offer a menu of options to the parties; they do not insist on one form of doing business. New entrants now know the array of choices available to them. Older firms can adjust their practices at a low cost per unit transaction. The risk of exclusion or collusion seems small. And price adjustments should work to eliminate any unintended forms of redistribution. It is not as though trade associations developed contracts between merchants to divide markets or rig prices, contexts where standardization in goods and terms facilitates collusive practices.<sup>18</sup> It follows, therefore, that custom in the sense of standard contract provisions should bind, no matter how great our doubts about the validity of implicit customs that are said to fill gaps.

Given this conclusion, it seems clear that the UCC takes an unwise step insofar as it seems to invoke course of dealing, trade custom, or course of performance to help construe the terms of an explicit contract.<sup>19</sup> I have not made any detailed study of the case law in this area, but Bernstein is surely correct to condemn the drafters or the interpreters of the UCC if they adopt an incorpo-

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<sup>18</sup> To be sure, the standardization of terms makes it easier to collude, but it also makes it easier for traders to compare prices and bundle transactions from different sources. Let the market have many traders and the antitrust risk seems small. And, in any event, the risk could be countered by other methods of social control.

<sup>19</sup> One risk of course of performance data is that it is hard to tell whether any given pattern found in a particular setting marks an application of the original standard agreement or a form of customized modification, applicable to one case only, which is facilitated by the UCC rule that validates contract modifications even when not supported by consideration. UCC § 2-209(1).

ration strategy that "reflexively incorporates customs into all contracts in a market, unless the customs are clearly and specifically negated, and looks to customs to interpret even explicit and facially unambiguous contract provisions."<sup>20</sup> The UCC's conception of commercial law is inconsistent with the standard English view that requires generalized commercial custom to yield to the specific unambiguous provisions of a contract.<sup>21</sup> The UCC's position should be rejected because of the way it interferes with freedom of contract.

It is not possible to give a longish explanation of how this could be the case, but the point becomes clear from Omri Ben-Shahar's discussion of the role of flexibility under the UCC.<sup>22</sup> Ben-Shahar takes the common situation of an installment contract that contains a provision stating that acceptance of late payment without penalty in any one period should not be construed as a waiver of late fees in any subsequent period. He then notes that courts are all too willing to imply waivers of these antiwaiver provisions from the acceptance of late payments, even when that provision has not been explicitly or separately waived.<sup>23</sup> Ben-Shahar's model seeks to demonstrate that the choice of legal rule makes (at least under conditions of perfect knowledge and costly enforcement) no difference to the overall level of payments that the creditor can obtain under his agreement. The only effect of the strict enforcement of these antiwaiver provisions is to change the period in which the opportunistic debtor will find it in his interest to duck payment.

No one believes that this conclusion holds without modification in our rough and tumble world. In part the problem is eliminated by other devices. The borrower who instructs his bank to pay his mortgage on the first day of the month surrenders the ability to delay payment, but he receives in exchange the benefit

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<sup>20</sup> Bernstein, 66 U Chi L Rev at 758 (cited in note 1) (footnotes omitted).

<sup>21</sup> See, for example *Les Affréteurs Réunis Société Anonyme v Leopold Walford (London), Ltd.*, [1919] AC 801, 809, which I endorsed in Epstein, 21 J Legal Stud at 7-8 (cited in note 5).

<sup>22</sup> Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 U Chi L Rev 781 (1999). His major argument is in favor of an invariance theorem that holds, at least as a first approximation, that parties will experience the same level of contractual erosion, given positive costs of contractual enforcement, regardless of whether the court limits waivers, typically of late fees, for a single period or holds that they bind for the duration of the contract. His point is that once the rule is known in advance, the rightholder will alter his behavior in response to the incentives. In an erosion regime, the creditor faces a rapid loss of rights from inaction, so he will spring to the defense of his rights more quickly than in an antierosion regime that confines each waiver to the payment it governs.

<sup>23</sup> Id at 790-91, citing *Westinghouse Credit Corp v Shelton*, 645 F2d 869, 873-74 (10th Cir 1981).

of lower costs and higher transactional reliability. The credit card company that simply adds late fees and interest to the running tab has little to worry about with respect to the waiver problem as well. When the creditor can withhold the shipment of further goods to the debtor, he has a powerful club with which to compel compliance. But all this said, some transactions will still expose creditors to the risk that Ben-Shahar discusses. In these cases, the very fact that creditors routinely insist on inserting strong antiwaiver provisions in their agreements suggests that they think these provisions help them manage their loan portfolios, by allowing them to make unbundled decisions for each payment that do not necessarily commit them to a similar course of action in the future. To read any course of performance or trade practice in the teeth of these clauses creates a presumptive inefficiency with no offsetting benefit. Insofar as implicit custom is used to undermine standard provisions, the UCC puts custom in a race with itself, and then backs the wrong horse.

## II. CUSTOM VERSUS COST/BENEFIT ANALYSIS

The question then arises whether we can find any cases in which these implicit customs should be relied on. Here I think that their importance is likely to be found in those cases where the explicit standard provisions do not take over because they cannot. Bernstein's cautions about the emergence of consistent trade custom rest on data drawn from closely knit industries with repeat players. In writing about custom in tort law, I noted that customary practices were likely to emerge in those settings where parties interacted with each other with a high level of frequency in reciprocal roles, as for example with trade practices.<sup>24</sup>

That conclusion was both more, and less, true than I stated there. It was more true because the customs that emerge in these settings will not be, as I tacitly presupposed, informal customs, of service in solving disputes over "due care" under the tort law. Rather these forces of repetitive interaction are likely to drive the relevant parties to explicit written contractual provisions like those found in standard trade agreements. These provisions should be construed as written, wholly without reference to the fractured history of their origins. Stated otherwise, my earlier oversight was to fail to recognize that the conditions that are ideal for the emergence of an implicit custom may also be ideal for the emergence of explicit bilateral contracts or standard trade

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<sup>24</sup> Epstein, 21 *J Legal Stud* at 11-16 (cited in note 5).

terms that eliminate any need to rely on informal practices. But it hardly follows that implicit customs should be of no value, because they continue to have a strong role to play in contexts in which no standard provisions are likely to be crafted.

This point is likely to prove of great importance in two separate contexts. First, in many situations the applicable question in tort law is whether a party took reasonable steps for its own self-protection. The issue will arise in just this form when the question is whether the plaintiff should be charged with contributory negligence in, say, the care of his own livestock that has been hurt by another. In some cases, moreover, the standard of care that one party owes to another is parasitic on the general approach to negligence, which requires of a defendant that he bring the same care to property entrusted to his care by the plaintiff as he brings to his own property, often in cases without robust functioning markets.<sup>25</sup> Thus in *Maynard v Buck*,<sup>26</sup> the question before the Court was in effect whether the drover gave the same care to his client's animals as he would have given to his own.<sup>27</sup> The key custom (how does one care for one's own animals?) is thus self-regarding; we should not expect to see any one standard contractual term develop that states the amount of care that one should take of his own animals. There is no transfer of property or services to which a contract can be attached: after all, who would sue whom and for what?

At this point, the legal question cannot look to any explicit contracts. The issue to be faced is how to determine the appropriate standard of care. Now the competitor to implicit social custom is no longer the standard contract, but rather the diffuse kind of cost/benefit analysis characteristic of the Hand Formula,<sup>28</sup> which asks the court to figure out from scratch what an efficient set of practices would look like. In dealing with this case, we have to worry about some of the same problems that plague the use of implicit customs in commercial transactions. But surely there are differences. Any individual who is faced with the question of what care to take of his own animals does not face the bargaining problems that arise in commercial transactions. He has no reason to be locked into an inefficient norm simply to gain access to

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<sup>25</sup> For discussion, see R.H. Helmholz, *Bailment Theories and the Liability of Bailees: The Elusive Uniform Standard of Reasonable Care*, 41 U Kan L Rev 97 (1992) (surveying American bailment cases decided since 1929 and concluding that no uniform standard of bailment liability exists).

<sup>26</sup> 100 Mass 40 (1868).

<sup>27</sup> Id at 47.

<sup>28</sup> See *United States v Carroll Towing Co*, 159 F2d 169, 173 (2d Cir 1947).

markets that operate on different terms. He has the luxury to pick and choose between various practices in order to find those that best suit him. It may well be that no consistent practice has emerged on the matter at hand. If so, then we are left with nothing better than a stab at a cost/benefit analysis to locate the proper standard of care among the welter of inconsistent practices. Accordingly, it is then open to the plaintiff to suggest some precaution the defendant could have taken and for the defendant to show that it is too costly, too counterproductive, or both.<sup>29</sup>

Yet it hardly follows that we should turn down the chance to rely on effective implicit customs when they do emerge. Since the custom concerns the relationship of an individual to his own animals, we do not have to worry about customs that benefit their practitioner while imposing losses on third parties. The rules of consistent care, when adopted by many parties and endorsed by many voluntary associations, are likely to give us better information about sound practice than any remote judicial judgment. In this context, at least, we can do better by relying on the local knowledge of Hayek than on the cost/benefit analysis of the judges, because all the on-the-ground incentives work in favor of a sensible accommodation. To put the point in its simplest fashion: even if explicit contracts trump informal custom, an informal custom may well trump an undifferentiated cost/benefit analysis.

The need to rely on informal custom is not confined to self-regarding acts. It also covers those settings where individuals interact with each other informally under circumstances in which they cannot enter into voluntary transactions. One common place of such interaction is a commons, for example, a beach or a path. Here the gains from coordination are critical to all the parties involved. Unlike certain battle of the sexes games, it is hard to envision the asymmetrical payoffs that come from cooperation in one form or another. If asked to decide whether walking or riding on the right or the left was somehow better, it is unlikely that one could find variations in the positions of key players that would make one solution preferable to another.<sup>30</sup> It follows therefore

<sup>29</sup> See Mark F. Grady, *Untaken Precautions*, 18 J Legal Stud 139, 143-44 (1989).

<sup>30</sup> To contrast this situation with the battle of the sexes game in note 13, note that this game takes the form:

A\B	Custom A	Custom B
Custom A	2, 2	-1, -1
Custom B	-1, -1	2, 2

Note that convergence in this game is likely to be facilitated by conversation between the parties, for bluffing has no gain. Nor do problems of interest groups play any role here. The same holds if the payoffs in the southeast box were (3, 3) instead of (2, 2), for then both parties would converge on the same single alternative.

that convergence to one single norm is likely to take place more rapidly than it does in industry contexts.

Even when we move into industry contexts, we can envision certain cases in which custom will become key to the success of the business because bilateral contracts are not feasible, because of the number of transactors and the difficulty of monitoring behavior. To give but one example, the evidence offered at trial in the famous case of *International News Service v The Associated Press* ("INS"),<sup>31</sup> noted a widespread industry custom to use "tips" (that is, stories found in other newspapers) only to identify possible topics for investigation and not to substitute for the investigation itself.<sup>32</sup> That custom could be enforced through retaliation, for it would not be too difficult to determine whether a subsequent story contained information separate and apart from that which one side had already published. The custom's utility comes from the way in which it promotes the long-term average advantage of the parties to it, so that normally they have only a limited incentive to deviate from it. Each newspaper can use its competitors as a source of inspiration; each knows that it will be protected in the investigative work that it does. In the long run, all are better off cooperating rather than deviating. Doubtless, deviations take place in secret, but in many of these cases one suspects that the violation of the custom was checked by supervisors in the violator's own firm.

Understood against this backdrop, the *INS* case presented an isolated deviation that oddly proved the durability of the initial rule. The Hearst papers were blocked from the German front by the British and French, so they either lifted news from the Associated Press or did without. But during that dispute, the custom was maintained in all other markets to which both news services had access. The custom, moreover, applied to more than these two news services and governed individual papers as well. *INS* makes it clear that some action may well follow because of a deviation from the practice.

For our purposes, the key element is that the rule regulates the way in which newspapers deal with information published by others. Yet it is unlikely that it will crystallize into a standard commercial agreement. One reason is that the custom is purely negative; the parties need not transact at all when they act in accordance with the rules. Another reason is that an explicit con-

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<sup>31</sup> 248 US 215 (1918), which I discussed at length in Richard A. Epstein, *International News Service v. Associated Press: Custom and Law As Sources of Property Rights in News*, 78 Va L Rev 85, 90-106 (1992).

<sup>32</sup> 248 US at 243-44.

tract requires someone to decide which of the various parties should intervene in the event of breach. Finally, allowing codification of this custom carries with it the obvious risk that the parties will enter into a horizontal restraint of trade that will run them afoul of the antitrust laws. If so, many reasons can explain the absence of an explicit arrangement, helping to account for the durability of this custom.

Cases of common usage of common property (whether the beach or the news) both present settings in which the commercial dynamic that Bernstein describes so well cannot occur. In these noncommercial settings, the informal customs should win out because they no longer go head-to-head with explicit contractual terms, of which there are none. In this context, the competitor to the informal custom is only the undifferentiated cost/benefit analysis in the hands of judges and juries. That cost/benefit analysis, made after the fact, has far less cogency than local custom. So understood, the relevant hierarchy reads as follows: explicit contract, first; local and implicit custom, second; and generalized cost/benefit analysis, third.